German inflation brings good news for ECB

Amidst speculation about the ECB's possible reaction to the stronger euro, the slight increase in inflation should bring some relief

Source: iStock

Based on the results of six regional states, German headline inflation increased to 1.8% YoY in August, from 1.7% YoY in July. The fourth consecutive rise of headline inflation. On the month, German prices rose 0.1 % MoM. Based on the harmonised European definition (HICP), and more relevant for ECB policy making, headline inflation accelerated to 1.8% YoY, from 1.5% following three months of near-stable inflation data.

Looking at the available components at the regional level shows today's increase was mainly driven by base effects from higher energy and food prices. Measures of core inflation remained stable. At the same time, the end of the holiday season pushed down inflation in leisure costs, and the ongoing decline in communication costs and lower prices for services continued to at least partly offset higher prices for consumer goods.

However, these latest figures could represent an inflation peak for this year. In the months ahead, cyclical factors like a stronger euro and base effects from lower energy prices, but also structural factors like increased competition in the service sector on the back of digitalisation, should again push down headline inflation.

The ECB will do everything it can to avoid unwarranted tightening of financial conditions

Ironically, for the ECB, today's German inflation data is good news, as it increases the likelihood that August inflation for the entire Eurozone, released tomorrow, will also show a small pickup. However, German inflation numbers will do little to hush the current discussion on the possible impact of the stronger euro on the ECB's tapering plans and the Eurozone in general.

In our view, next week the ECB will probably want to play down the possible negative impact from the recent euro appreciation on both Eurozone growth and inflation, stressing strong domestic demand and low-interest rates. For the time being, the ECB will try to present the stronger euro as an achievement rather than a problem.

When preparing its game plan for tapering, the ECB will do everything it can to avoid what it often refers to as "unwarranted tightening of financial conditions". 'Dovish tapering' and 'tapering is not tightening' should be the leitmotivs of the ECB's next steps.

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